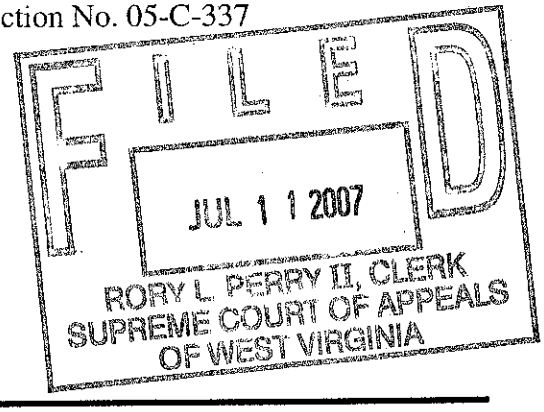
**IN THE WEST VIRGINIA SUPREME COURT OF APPEALS**

BARRY D. SCHMEHL, an individual
as an officer of Filly's of America, Inc.
Appellant,

v.

VIRGIL T. HELTON,State Tax
Commissioner of West Virginia,
Appellee.

Docket No. 33379
From the Circuit Court of Jefferson County,
West Virginia
Civil Action No. 05-C-337

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APPELLANT'S REPLY BRIEF

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## POINTS AND AUTHORITIES

A. THE CIRCUIT COURT'S INDEPENDENT, BELATED AND ADVERSE FINDING, AS AN APPELLATE TRIBUNAL, ABOUT THE CREDIBILITY OF THE APPELLANT'S TESTIMONY, BEING BASED ON AN ERROR IN THE PURPORTED TRANSCRIPT OF THE EVIDENTIARY HEARING BEFORE THE TRIER OF FACT, IS IMPROPER, HIGHLY PREJUDICIAL AND ERRONEOUS, AND THE APPELLEE OFFERS NOTHING TO JUSTIFY IT.

The Circuit Court's Order, despite the Appellee's not having argued the point, "emphasizes that [Appellant] contradicted himself at the Tax Appeal Office's hearing by stating that he did not own stock in Filly's and then a few minutes later denying he owned stock." Order, at last page, first paragraph (Emphasis added). Apparently influenced by this purported contradiction, the Circuit Court then stated that "[t]herefore, the Court finds [Appellant's] self-serving testimony that he was only a contract worker and was not in fact an officer suspect." Id.(Emphasis added). The truth is that the Appellant never owned stock in the corporation and never consciously claimed that he did. [1]Likewise, he never denied his formal status as an officer of the corporation.

In attempting to rebut the Appellant's contentions of prejudice and error based on such a "finding" by the Circuit Court acting as an appellate tribunal, the Appellee offers no affirmative justification for the Circuit Court's action, but would merely argue the timeliness, and absence of authority in support, of the Appellant's argument.

Thus, starting with the hearing of this case before the Administrative Law Judge (via video conference), through the appeal to Circuit Court and the subsequent appeal to this Court, the Appellee does not argue that the Appellant's testimony was not, in fact, credible due to the purported contradiction in his testimony about stock ownership. Likewise, there was nothing in the Administrative Decision finding any such thing. Rather, it was the Circuit Court,

[1] See Affidavit, dated July 6, 2007, from the Executive Director of the West Virginia Office of Tax Appeals, attached as Appellant's Reply Brief Exhibit A.

sitting as an appellate tribunal, that first made a finding in its Final Order about the credibility of the Appellant's testimony based on such a purported contradiction.

As to the timeliness of the Appellant's objection, the record of this matter is clear that he did, in fact, challenge the Circuit Court's finding of his testimony being "suspect" at the very first opportunity he had – after its initial publication in the Final Order of the Circuit Court – to-wit: in his Petition for Appeal to this Court.

Furthermore, that the Circuit Court's independent, *sua sponte* finding about the credibility of the Appellant's testimony, when acting as an appellate tribunal, was improper, prejudicial and erroneous is borne out by the decisions of this Court. Specifically, this Court has consistently held that, in its application of the "clearly erroneous" standard to the factual findings of a trier of fact, a reviewing court should give particular deference to findings about the credibility of witnesses. Patton v. Gatson, 207 W.Va. 168, 530 S.E. 2d 167 (1999); Board of Education v. Wirt, 192 W.Va. 568, 453 S.E. 2d 402, (1994). The logical corollary to that long-standing principle is that, where, as here, the trier of fact did not make an express finding that the credibility of the Appellant's testimony was "suspect," it was error for the Circuit Court, acting as a reviewing tribunal, to do so.

B. THE CIRCUIT COURT ERRED IN FINDING THAT THE APPELLANT, AS A NOMINAL OFFICER OF THE CORPORATION, WAS *PER SE* LIABLE FOR ITS TAX DEFAULTS AND THE APPELLEE'S MISSTATEMENT OF THIS COURT'S PRIOR RULINGS ON THAT QUESTION FAIL TO ESTABLISH OTHERWISE.

One of the substantive statutes applicable to this matter is set forth at W. Va. Code § 11-15-17 and provides that:

> If the taxpayer is an association or corporation, the officers thereof shall be personally liable, jointly and severally, for any default on the part of the association or corporation, and payment of the tax and any additions to tax, penalties and interest thereon imposed by article ten of this chapter may be enforced against them as against the association or corporation which they represent.

In his opening brief, the Appellant noted this Court's recognition of the possibility that the above statute could be applied in an unconstitutional manner. State ex rel. Haden v. Calco Awning and Window Corp., 153 W.Va. 524, 170 S.E. 2d 362 (1969).

Specifically, in State ex rel. Haden v. Calco Awning and Window Corp., individual officers of the taxpayer corporation contended, and the lower court agreed, that the statute was unconstitutional on its face because it purported to render them personally liable for the corporation's tax by mere virtue of their status as officers, thus taking their property without due process of law. Id.

While reversing the lower court's ruling, this Court remanded the case for a determination as to whether the taxpayer could show by clear and cogent evidence that the application of the statute in that case had been "so unreasonable or arbitrary as to amount to a denial of due process of law ." Id. (quoting Norfolk and Western Railway Company v. Field, 143 W.Va. 219, 100 S.E.2d 796 (1957), syl. pt. 4.)

Thus, it is the Appellant's position that, based on the holding in State ex rel. Haden v. Calco Awning and Window Corp., it is clear that: (1) to preserve its constitutionality, W. Va. Code § 11-15-17 must be construed to require a reasonable and not an arbitrary or capricious application; and (2) one's mere status as an officer is alone insufficient to satisfy that construction.

In Appellee's Response, he argues, contradictorily: (1) that Appellant's reliance upon this Court's holding in State ex rel. Haden v. Calco Awning and Window Corp., is misplaced; (2) that Appellant cites no authority for his contention that the practical limitations, on his capacity to use corporate funds to pay its taxes, absolve him of responsibility for the

failure to pay such taxes and (3) that citations to parallel federal tax laws do not pertain to the issues here.

Specifically, the Appellee quotes a passage from this Court's State ex rel. Haden v. Calco Awning and Window Corp. opinion wherein, disagreeing with that taxpayer's argument, the Court simply held that, because the statute may be capable of being applied in an unconstitutional manner, does not mean that the statute is facially unconstitutional. Two paragraphs later, however, this Court went on to say that "[t]his Court has repeatedly held that a statute may be constitutional on its face but may be applied in an unconstitutional manner." Id. at 530, 366.

Likewise, Appellant does not argue that W. Va. Code § 11-15-17 is unconstitutional on its face. Rather, the Appellant merely argues that the Court has recognized that the statute is capable of being applied in an unconstitutional manner where, such as here, the Appellant functioned as secretary of the corporation in name only.

Indeed, in another case where it construed W. Va. Code § 11-15-17, this Court stated that the "the test to determine whether an individual may be held statutorily liable for unpaid corporate tax is whether the person has acted as a corporate officer." Frymier-Halloran v. Paige, 193 W. Va. 687, 692, 458 S.E.2d 780, 785 (1995) (emphasis added).

In an even more recent decision, the West Virginia Office of Tax Appeals (OTA) itself recognized that, to impose liability under W. Va. Code § 11-15-17, an individual must possess actual authority. Specifically, the OTA found that "[e]ffective on and after July 15, 1993, the consumers' sales and service tax legislative regulations follow the broad reach of W. Va. Code § 11-15-17 by basing corporate officer liability for unpaid corporate consumers' sales and service tax liability upon the corporate officer's status as a corporate officer, as long as that

officer, during the assessment period(s), had any actual managerial authority on behalf of the corporation, that is, he or she was not merely an officer in name only." Administrative Decision 06-026C, 06-027W, West Virginia Office of Tax Appeals (April 7, 2006) (emphasis added).

Although Appellant readily acknowledges that W. Va. Code §§ 11-10-9 and 11-10A-10 impose a burden upon a taxpayer to show that an assessment is contrary to law, a burden which Appellant argues he has satisfied, an equally well-settled rule of statutory construction is that statutes which purport to impose tax are to be liberally construed in favor of the taxpayer and strictly construed against the State. See Calhoun County Assessor v. Consolidated Gas Supply Corp., syl. pt. 1, in part, 178 W. Va. 230, 358 S.E.2d 791 (1987) ("Statutes governing the imposition of taxes are generally construed against the government and in favor of the taxpayer."); accord Consolidation Coal Co. v. Krupica, 163 W. Va. 74, 80, 254 S.E.2d 813, 816 (1979); Ballard's Farm Sausage v. Dailey, 162 W. Va. 10, 246 S.E.2d 265 (1978); In re Estate of Evans, 156 W. Va. 425, 194 S.E.2d 379 (1973).

As this Court recently reiterated in a case concerning an appeal from a circuit court's ruling that enjoined the Appellee from enforcing the health care provider tax, where "the statute to be interpreted concerns taxation; we usually construe the tax law in a manner that is favorable to the subject taxpayer." Coordinating Council for Independent Living, Inc. v. State Tax Commissioner, 209 W. Va. 274, 281, 546 S.E.2d 454, 461 (2001). Where, as here, the statute would impose liability on one individual for a separate, putative taxpayer's non-payment, the policy underlying that rule of construction is all the more compelling.

Thus, upon applying the rules set forth by this Court in Coordinating Council, Calco Awning and Frymier-Halloran, and construing W. Va. Code § 11-15-17 and the applicable legislative regulations, it is clear that: (1) as a statute imposing tax liability, it is to be construed

favorably to the taxpayer; (2) to preserve its constitutionality, the subject statute must be construed to require a reasonable and not an arbitrary or capricious application and (3) one's mere status as an officer is alone insufficient to satisfy that construction.

As presented in the Appellant's initial brief, the foregoing "facts and circumstances" approach is comparable to that applied in the equivalent scheme under the federal payroll tax system that imposes personal liability on persons actually responsible for satisfaction of a corporate employer's obligations thereunder. See 26 U.S.C. §6672.

In applying Section 6672, the federal courts have held that possessing and exercising the mere mechanical function of preparing payroll tax returns does not, by itself, confer "responsible person" status when others have the ultimate authority to approve the actual remittance of the taxes shown to be due on such returns. See Godfrey v. U.S., 748 F.2d 1568 (Fed. Cir. 1984) ("The mechanical duty of signing checks . . . [is] not determinative of liability under § 6672.") Id. at 1575; Plett v. U.S. 185 F.3d 216 (4th Cir. 1999); O'Connor v. U.S., 956 F.2d 48 (4th Cir. 1991); and Secret v. U.S., 373 F. Supp. 2d 619 (USDC N. Dist. of W.Va. 2005).

To avoid addressing the persuasive reasoning of such federal court decisions on a virtually identical statutory tax structure, the Appellee merely argues that the large body of judicial holdings, about the substance of the federal version of the rules for a corporate officer's vicarious tax liability, "does not pertain" to the issues here. Incredibly, then as to the Appellant's third and final assignment of error, regarding the applicable statute of limitations, the only judicial authority the Appellee can cite to justify the Circuit Court's ruling is a *federal* tax case. See, United States v. Galletti, 541 U.S. 114 (2004), *infra.*

Thus, notwithstanding the Appellee's contradictory arguments otherwise, employing the necessarily liberal construction of the governing statute to avoid its unconstitutionally unreasonable, arbitrary and capricious application in this case, Appellant should only be found liable for the corporation's tax if he, as an officer, was able to exercise the ultimate authority over the disbursement of its funds to pay such tax. The evidence in the record shows that the Appellant lacked such authority.

Thus, the Circuit Court's Order, sustaining the OTA Decision on that question, is clearly erroneous and is based on an incorrect legal standard: (1) in concluding that the Appellant is liable to pay the corporation's tax liability merely because of his nominal status as an officer of the corporation; (2) in failing to liberally construe in the Appellant's favor the statute that was the basis of the assessment against him and (3) in concluding that the Appellant is liable to pay the corporation's taxes despite the fact that he did not possess or exercise ultimate authority over the disbursement of its funds.

C. IN CONCLUDING THAT A PORTION OF THE ASSESSMENT AGAINST THE APPELLANT WAS NOT BARRED BY THE APPLICABLE STATUTE OF LIMITATIONS, BELYING THE APPELLEE'S CONTENTION THAT THERE WAS NO SEPARATE ASSESSMENT AGAINST THE APPELLANT, THE CIRCUIT COURT ERRONEOUSLY DEFERRED TO THE APPELLEE'S LEGISLATIVE REGULATION WHICH IMPROPERLY EXTENDED AND MODIFIED THAT STATUTE.

The statute governing the time within which all assessments of tax, interest and penalties must be made provides as follows:

> (a) *General rule.* – The amount of any tax, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable shall be assessed within three years after the date the return was filed (whether or not such return was filed on or after the date prescribed for filing): Provided, That in the case of a false or fraudulent return filed with the intent to evade tax, or in case no return was filed, the assessment may be made at any time.

W.Va. Code § 11-10-15.

At the same time, according to the Appellee's legislative regulation that he would apply to matters of this kind, an officer can become liable for a corporation's tax liability whether the determination of that liability is based on filed returns or a legally final assessment against the corporation. 110 Code of State Regulations, series 15, § 4a.4.

In this case, the corporation's liability for the periods ending in September, 2000, was determined in the Corporate Assessment dated December 8, 2000. The Corporate Assessment became legally final sixty (60) days hence, to-wit: February 6, 2001. However, the Assessment against the Appellant, including the corporation's liability for the periods ending in September, 2000, was not issued until November 15, 2004, or more than nine (9) months after the third anniversary of the date on which the Corporate Assessment became legally final.

Thus, it is the Appellant's position that, for the periods covered by the December 8, 2000 Corporate Assessment, the separate Personal Assessment against him is barred by the general three-year statute of limitations. W.Va. Code § 11-10-15(a).

In its Order, the Circuit Court concluded that the Appellant's reliance on In re Bowen, 116 B.R. 477 (Bankr. S.D. W. Va. 1990) is misplaced because the Bowen Court did not address nor have the benefit of Section 4a of Title 110, Series 15 of the West Virginia Code of State Regulations, which were promulgated three years later.

That the legislative regulations, purportedly extending the statute of limitations for the imposition on the Appellant of the earlier portions of the corporation's consumers' sales tax liability, did not exist in their current form in 1990 is of no moment here. Unquestionably, the relevant statute was in place at that time. Thus, interpreting W. Va. Code §11-10-16(a), the United States Bankruptcy Court for the Southern District of West Virginia determined that W. Va. Code § 11-15-17, imposing liability upon officers of a corporation, does not constitute a

collection action limited by W. Va. Code § 11-10-16(a). In re Bowen, 116 B.R. 477, 480 (Bankr. N.D. W. Va. 1990).

In reaching this conclusion, the Bowen Court aptly noted that the "plain reading of § 11-15-17 makes clear that, as to officers of a corporation, payment in the amount of delinquent corporate sales tax and related liabilities is to be 'enforced against them as against the association or corporation which they represent.'" Id.

Further, the Bowen Court noted that "[t]he West Virginia Code separately treats limitations on assessment and on collection in §§ 11-10-15 and 11-10-16. The West Virginia Code authorizes collection by foreclosure in § 11-10-12, or by levy and distraint in § 11-10-13."

Because the assessment in this case against the Appellant is not a collection action pursuant to W. Va. Code §11-10-16(a), the five [or ten] year statute of limitations set forth in that section is inapplicable and as such, the portion of the present assessment against the Petitioner for periods ending September, 2000, but not issued until November 15, 2004, is barred by the general three-year statute of limitations set forth in W.Va. Code § 11-10-15(a).

In his Response to the Appellant's Petition to this Court, the Appellee understandably omits any reference to Bowen, which construed and applied the West Virginia tax statute, and, instead, cites a ruling of the United States Supreme Court construing and applying a federal tax statute. See, United States v. Galletti, 541 U.S. 114 (2004). He also further argues: (1) that there was no separate assessment against the Appellant to which the statute of limitations would apply; and (2) the statute of limitations for assessments contained in W.Va. Code § 11-10-15 only applies to determinations of the amount of the liability – not determinations of the identity of who is liable.

As to the Appellee's citation of Galletti, not only does that sharply clash with his earlier contentions that federal tax law "does not pertain" to the issues here, but there is a more fundamental reason why the holding in such a case applying federal tax law does not support the his position here.

In Galletti, the Court was addressing the question of whether the liability for taxes established pursuant a timely and legally final assessment against a general partnership could be collected from its partners, notwithstanding that the period to assess the partners individually had expired. Id. In holding that the IRS could collect the partnership's liability from the partners, the Court concluded that the partners, while not being the actual taxpayers, were "by reason of state law, liable for payment of the [general partnership's] debt." Id., at 123. Specifically, the state law to which the Court referred was the familiar one pertaining in all states making general partners jointly and severally for *any* debts of their partnership.

Here, in the case of a corporate officer – as opposed to a general partner – it is only by virtue of the specific statutes allowing the piercing of the corporate veil in the case of trust fund taxes that, in specific circumstances, a corporate officer may be held liable for the corporation's failure to pay such taxes. W.Va. Code §§ 11-10-5j and 11-15-17. Importantly, the former of those statutes expressly provides, as the Bowen Court recognized, that to impose such vicarious liability on a corporate officer "[t]he amount of such moneys shall be assessed, collected and paid in the same manner and subject to the same provisions and limitations (including penalties as are applicable with respect to the taxes [in this case, assessed against the corporation]." W.Va. Code § 11-10-5j. (Emphasis added).

As noted above, the Appellee also contends that, on the basis of his legislative regulation, what he denominated throughout this proceeding as an "assessment" against the

Appellant was, in reality, not an assessment at all, but merely an action to collect the earlier assessment against the corporation. Thus, he would argue that the three-year statute of limitations applicable to assessments does not apply to the assessment against the Appellant for the corporation's taxes.

Not only do the Appellee's actions in issuing the "assessment" against the Appellant belie his denial of the same, but his contention about no separate assessment flies directly in the face of the plain and unambiguous language of the governing statute as quoted above. Moreover, as shown in the Appellant's initial brief to this Court, to the extent the legislative regulation would purport to modify that clear statutory language, it is invalid and represents an incorrect legal standard.

As to the Appellee's second point that the statute of limitations for assessments only fixes the amount of a tax liability, and does not fix who is liable, one need only consider the related statute providing for the continued accrual of interest on unpaid tax liabilities to see the illogic of that contention. See, W. Va. Code § 11-10-17. That is, the expiration of the statute of limitations for assessments does not fix the final amount of liability, but it does limit imposition of that liability to the person or persons who have been properly and timely assessed within its terms.

Indeed, by contrast, the statute of limitations on collections, which the Appellee contends applies to authorize the late assessment against the Appellant, contains no language making it the rule applicable to determining the identity of liable parties. See, W.Va. Code § 11-10-16. Thus, it was left to the Court in Bowen to construe that section as only applying once a timely assessment had been issued, within the period allowed by W.Va. Code § 11-10-15, identifying from whom the liability could be collected.

Accordingly, the Circuit Court's Order, deferring to the invalid legislative regulation, is clearly erroneous and is based on an incorrect legal standard in concluding that the Appellant is liable to pay the corporation's taxes for periods prior to November, 2001. Thus, the separate and distinct assessment of the same, expressly issued against the Appellant by the Appellee, is barred by the applicable statute of limitations.

## CONCLUSION

Based on the evidence in the record of this matter, the Appellant's initial brief, the foregoing points and authorities, and the relevant statutory and case law in support thereof, it is respectfully submitted that the Circuit Court's Order denying Appellant's Petition for Appeal should be reversed and overruled, and that the Administrative Decision should be set aside.

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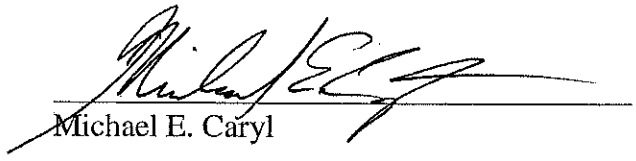
CERTIFICATE OF SERVICE

I, Michael E. Caryl, Esquire, do hereby certify that a true and exact copy of the foregoing Appellant's Reply Brief has been served, by United States Postal Service, postage prepaid, upon the following:

A. M. "Fenway" Pollack, Esquire
Assistant Attorney General
State Capitol, Room W-435
1900 Kanawha Blvd., East
Charleston, West Virginia 25305

this 9th day of July, 2007.



Michael E. Caryl

# APPELLANT'S REPLY BRIEF
# EXHIBIT A

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CHIEF ADMIN. LAW JUDGE

## AFFIDAVIT

RE: Barry D. SCHMEHL, an individual, as an Officer of Fillys of America, Inc.
WV Office of Tax Appeals' Docket No. 05-023 C
SUBSTANTIVE TRANSCRIPTION ERROR DISCOVERED on July 5, 2007

Upon the oral request of Michael E. Caryl, Esq., counsel for the Petitioner in the above referenced matter, on July 3, 2007, and pursuant to the ensuing direction of R. Michael Reed, the Chief Administrative Law Judge of this tribunal, I, Stephen P. Lee, Executive Director and "Clerk of Court," on July 5, 2007, conducted an independent review of a recorded evidentiary hearing transcript in this matter. I played and thoroughly reviewed this audio recording at least ten (10) times during this review, and it is perfectly clear that a clerical error by the transcriptionist is set forth in the written transcript as follows.

On page 16, line 291, of this hearing transcript, the Petitioner's counsel, Mr. Caryl, is conducting a line of questions toward his witness, the Petitioner Barry Schmehl. The existing written transcript states here: "Do you have any stock in the corporation?" My thorough review of the audio recording discloses that the actual question clearly was: "She have any stock in the corporation?" In context, this question appears to be referring to an Angela Frailly, whom the witness just identified as the vice-president of the corporation.

I, Stephen P. Lee, do hereby acknowledge the above statements as true and correct.

Stephen P. Lee, Executive Director/"Clerk of Court" — Date 7-6-2007

STATE OF WEST VIRGINIA - COUNTY OF KANAWHA

The foregoing affidavit was acknowledged before me this 6th day of July, 2007 by Stephen P. Lee

Notary Public Pamela E. Buffington
My Commission expires Dec. 1, 2009

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